IN THE DISTRICT COURT OF THE UNITED STATES
DISTRICT OF SOUTH CAROLINA
CHARLESTON DIVISION

ROBERT J. NAGY, YURI DEBEVC,	)	2:08-CV-2555
Plaintiffs	)	Charleston,
	)	South Carolina
VS	)	June 17, 2010
UNITED STATES OF AMERICA,	)	
Defendant	)	

TRANSCRIPT OF PRETRIAL HEARING
BEFORE THE HONORABLE DAVID C. NORTON,
CHIEF UNITED STATES DISTRICT JUDGE

APPEARANCES:

For the Defendant: MR. NATHAN CLUKEY
MR. GREGORY SEADOR
MS. ELLEN WEIS
US Department of Justice Tax Division
P.O. Box 7238
Ben Franklin Station
Washington, DC 20044

For the Plaintiff: MR. LINDSEY W. COOPER, JR., ESQ.
LW Cooper Jr. Law Offices
36 Broad Street
Charleston, SC 29401

MR. YURI DEBEVC
Appearing pro se

Court Reporter: Amy C. Diaz, RPR, CRR
P.O. Box 835
Charleston, SC 29402

Proceedings recorded by mechanical shorthand, Transcript produced by computer-aided transcription.

THE COURT: Okay. I'm ready when y'all are.

MR. COOPER: Thank you, Your Honor, Lindsey Cooper for Robert J. Nagy.

THE COURT: Uh-huh.

MR. DEBEVC: Yuri Debevc, pro se.

MR. CLUKEY: Nathan Clukey for the United States.

MR. SEADOR: Greg Seador for the United States.

MS. WEIS: Ellen Weis for the United States.

THE COURT: Okay. All right.

So we've got a couple of motions in limine, and we've got the Motion to Bifurcate.

And so who filed first? I guess it looks like the first one filed is -- unless you -- unless y'all have an organized way to proceed, I'll be glad to do it anyway. I'm -- all right.

The United States's third motion in limine to exclude Nagy's witnesses John Kern and Ben LeClercq, I think has been partially satisfied, because Ben LeClercq is not going to testify. So it's just John Kern.

All right. Yes, ma'am?

MS. WEIS: Your Honor, we filed this motion because seeing as John Kern, who you may be familiar with, is an attorney who provided litigation counsel to Derivium Capital, Veridia Solutions, Yuri Debevc, Charles Cathcart, and also in connection with litigation arising out of the 90% Loan

scheme, we understood Mr. Kern's role to be exclusively an attorney for the parties in those lawsuits. We did not understand him to have any personal knowledge or to be a pertinent witness in any regard.

However, Mr. Nagy has had -- we have -- there was substantial justification for him not to disclose Mr. Kern as a witness until a few weeks ago in his trial witness disclosures.

THE COURT: So that was my question. He was not initially identified as a witness in any answers to interrogatories or anything until very recently?

MS. WEIS: Correct.

THE COURT: He was not listed somewhere and nobody paid attention to it; he was just not identified, period. Okay.

MS. WEIS: Mr. Nagy has identified two reasons for this.

One, because he may not actually call Mr. Kern, but that is not a reason or an exception to the Rule 26 disclosure requirements.

And two, because Mr. Kern is mentioned in one of the many, many depositions that have been taken in many of the various actions that arose here.

Now, that alone is not enough to justify failing to disclose him as a potential witness. And we cite at least

one case in the Fourth Circuit, which is *Quesenberry*, which is a Western District of Virginia case from April of this year, that said that the mere fact that a witness's name appears in documents that were produced during discovery is not sufficient to put the other parties on notice that he might have discoverable information or be a potential witness.

Moreover, the way in which it was described in the Scrantom deposition, which is the deposition that Mr. Nagy references, is simply that, again, he was litigation counsel, and that anyone at the firm that he was a member of, 10 State Street, had no personal knowledge of the two subjects that he has been identified as being able to offer testimony on as a fact witness.

Now, under *Southern States*, which is a Fourth Circuit case from 2003, the Court has to look at a variety of factors in determining whether or not there was substantial justification or harm to the Government here.

And that's important to consider because as THE Fourth Circuit says in *Southern States*, the purpose of Rule 37 is to prevent prejudice or surprise to the party to whom the disclosures were made.

In this case, Mr. Nagy bears the burden of proof on showing why his witness should not be disclosed or should not be excluded.

Now, we would say that there is substantial harm to the Government here. The centrality of the two issues that Mr. Kern is going to be called to testify on, whether or not there was the systems of hedging and whether or not there was an assistance of a bona fide lender, were heavily litigated during discovery. We went to, as we mentioned in our brief, Hong Kong and Isle of Man. We have acquired witnesses on this and deposed many witnesses, including Mr. Nagy himself, who rents office space with Mr. Kern and knows Mr. Kern before the commencement of this litigation. But at no point prior to May 20th did Mr. Nagy identify John Kern as a potential witness.

Now, the fact that we may be able to cross-examine Mr. Kern, as Mr. Nagy points out, at trial does not cure the prejudice to the United States. And that is specifically pointed out by the District Court in *Southern States*, and with which was affirmed by the Fourth Circuit in 2003.

We also can't cure this prejudice by deposing Mr. Kern. Because trial is, first of all, scheduled to begin on Monday, we obviously are outside of the discovery period and lack authority to compel his deposition. And we've attempted to contact him and meet with him to understand what it is he could potentially be testifying to that would be admissible evidence.

Mr. Kern has refused to meet with us. In the one

short call that we had with him, he specified that he would be subject to attorney-client privilege, possibly on a number of topics. And also, the only document -- the only -- the only foundation that he alluded to that he might have, or any testimony that he would give, is that he had seen, you know, documents, is rank hearsay.

So we believe that there is nothing that Mr. Kern would testify to that is admissible evidence.

Now, Mr. Nagy, in his reply brief, says that he could testify based on, you know, provided admissible testimony because as an attorney for his clients, he conducted due diligence.

First of all, that would still seem to indicate that there is privilege concerns that we have no indication there has been a waiver of.

And second, due diligence would necessarily consist of speaking to other people, which would be hearsay, and viewing documents, which is again hearsay.

So we don't believe that, you know, even if Mr. Kern were to testify, he would be offering any sort of admissible evidence.

It's also concerning that he's going to be relying, we believe, on documents and testifying from those documents, because that's the nature of expert testimony. And that only serves to underscore the prejudice to the Government from the

fact that this was not -- Mr. Kern was not disclosed until a few weeks ago.

So in sum, looking at, you know, the extent of what is unknown about Mr. Kern, the fact that what he's going to offer as testimony, as far as we know, is hearsay, that we were not put on notice that he might be a potential witness until May 20th, the fact that he is litigation counsel, should no more put us on notice to saying that Mr. Cooper himself might be a potential witness.

And there is simply no, as far as we can tell, way in which the Court can accommodate this late disclosure without severely disrupting trial.

And on that last point, that I would point out that in addition to meeting to depose Mr. Kern, we would also need to voir dire the jury panel that's been panelled, because as an attorney who has been practicing in Charleston for several years, as far as we know, it is more likely than not that there is the potential that a witness or a -- I'm sorry -- that a juror has some sort of contact with Mr. Kern.

And we would like the opportunity, at a minimum, to identify any potential harm there, as well.

THE COURT: Okay. Thank you.

Yes, sir?

MR. COOPER: Your Honor, he is on the witness list. I will say that he was not in the 21(a) disclosures or any

other discovery.

THE COURT: So he was not disclosed at all until May the 20th of this year?

MR. COOPER: Well, I -- in my responses to written discovery, yes, Your Honor.

THE COURT: Okay.

MR. COOPER: Under 26(e), though, the supplementation is and the meaning of the Rule is you don't have to constantly keep on supplementing written discovery, you do the best you can at the time.

I came to learn, and they are very aware of the arbitration awards, Mr. Kern's role. He's been discussed in the deposition they talked about. I don't believe there is any surprise.

They traveled to the Isle of Man and Hong Kong, which would just suggest that they should have stuck a little bit closer to home.

THE COURT: Why would you stick closer to home when you didn't list him as a witness? I mean, there is tens of thousands of documents in here. There is hundreds of people in here. I mean, you could make the same argument for that guy from Lichtenstein. I mean, he's mentioned in the documents. Are you going to call him? I mean, this is not like it's about six witnesses. There are hundreds of witnesses in this trial.

MR. COOPER: I understand. And this is a large case. And you are very aware of the largeness of it. And that's another reason for picking through discovery as discovery becomes available and known, that's the purpose of the Rule.

THE COURT: Now you are not telling me that John Kern's name wasn't known to you two years ago?

MR. COOPER: It was known, um, I didn't know exactly what his role was.

THE COURT: Did you sit through this month trial that I had in the same case last year?

MR. COOPER: I didn't sit through any of it, Your Honor.

THE COURT: You are lucky.

Isn't he, Mr. Debevc? He's lucky he didn't sit through it.

MR. DEBEVC: Yes, he is, Your Honor.

THE COURT: Okay.

MR. COOPER: And I know that the Justice Department was there.

I don't know if he was disclosed or not, but Mr. Kern, it's very important to our case, is the Government said there was these false statements about hedging, and the individuals that were involved at Derivium were all told that they were hedging.

Mr. Kern is a lawyer, you know, sat next to Mr. Cathcart. He couldn't allow untruthful testimony to occur. And his understanding that there was the synthetic puts and calls, that's all he's going to testify to. No surprise. Five minutes of testimony.

THE COURT: Okay. And he wasn't -- he wasn't read off as a witness at the voir dire of the jury in the jury selection?

MR. COOPER: My recollection is no, Your Honor.

THE COURT: Okay. All right. Anything else, Ms. Weis?

MS. WEIS: No, Your Honor.

THE COURT: Okay. All right.

Next one is Mr. Nagy's motion to strike Government Witnesses Robert Gee and Evan Cohen.

Yes, sir?

MR. COOPER: Yes, Your Honor.

Basically for the same reasons the Government's going to argue about looking behind the 6700 assessment for the reasons that are listed behind Mr. Gee about talking about the 6700 assessment in the investigation we sought to exclude for those exact same reasons.

My understanding from the brief is that it is likely not at issue because of your ruling, but it's those reasons, the actual investigation of the 6700 and the assessment is

not at issue.

I think what's more troubling is they've listed him to come testify and authenticate IRS transcripts from Mr. Nagy. Mr. Nagy did not file tax returns, I believe, from 2003 to 2005.

And I think this was brought out before Your Honor in the Derivium matter about whether that could be brought into attack, Mr. Nagy's character.

And that is another reason that we are seeking to exclude him is Mr. Nagy not filing tax returns has no bearing on the tax advice that he gave to his client Derivium, as to his opinion whether it was a sale for federal income tax purposes.

And the second reason for looking to strike Mr. Gee is because of the prejudicial nature.

THE COURT: So you are not moving to strike these witnesses because they were not identified to you in a timely manner?

MR. COOPER: Thank you for reminding me. That's Mr. Cohen.

MR. CLUKEY: Your Honor, can we address Mr. Gee first and move on to Mr. Cohen?

THE COURT: So Mr. Gee was identified during the discovery period?

MR. COOPER: I tried to take his deposition, Judge

Carr told me no, and you affirmed Judge Carr. So I don't see how he could come testify now.

MR. CLUKEY: Your Honor, if I may address --

THE COURT: Sure.

MR. CLUKEY: We identified -- Mr. Cooper is correct -- we identified Robert Gee initially to be able to rebut testimony that would come in regarding the 6700 investigation. You overruled that. Information wasn't communicated that shouldn't come in.

Now to the extent that they opened the door in any sense, we would, of course, preserve our right to call him in rebuttal, if that testimony is put squarely in the issue.

THE COURT: So he's not going to be a part of your case in chief?

MR. CLUKEY: He's not part of our case in chief, no, Your Honor.

Secondly, on this issue of the tax returns, the issue here in this case is materially different than what happened from what took place in the bankruptcy action, Your Honor.

This is a case about scienter.

THE COURT: Now, when you talk about the bankruptcy action, what are you talking about?

MR. CLUKEY: I'm sorry. The camel versus cat.

THE COURT: You are talking about the trial?

MR. CLUKEY: Right. The trial. And Mr. Nagy was a witness there.

My understanding -- I didn't -- I wasn't a party to this, but my understanding was that they tried to get in -- somebody tried to get in some -- the fact that he failed to file taxes.

This case is Mr. Nagy's scienter and his compliance with the tax laws under 6700. Obviously, there is a scienter element, and that is the main issue that we are required to prove right now.

There is a case by the Supreme Court, 1985, *U.S. vs. Boyle*, and that's -- this is cited in our brief -- and the case stands for the unremarkable proposition that everybody knows you have to file your own tax returns and you've got to pay your taxes on time when they are due. So this is something that everybody knows.

Mr. Nagy, at the same time that he was providing tax advice, supposedly objective tax advice to Derivium Capital, and he claims that he did not know that the 90% Loan Program violated the tax laws, at the same time he's providing this tax advice, he's failing to comply with the most basic of federal law concerning taxes, he's failing to both file his tax returns and is failing to pay his taxes. This is directly relevant to what he knew or had reason to know concerning the tax laws.

There are Fourth Circuit decisions we've cited, there are a number of them, we cited two in our briefs that have said the Court may consider -- juries may consider evidence of someone's failure to file tax returns or failure to pay their taxes in nontax cases where that could shed some light on the -- on, um, circumstantial evidence.

For example, in drug cases, we cite a drug case where that testimony was allowed to show that a person participating in a drug conspiracy, by failing to file their tax returns, which reflects the money that they were earning at the time.

So 404(b) --

THE COURT: Isn't there a difference between failing to file income taxes and failing to pay income taxes? The failure to file them is a criminal act; failure to pay is a civil act?

MR. CLUKEY: Failure to file can be a criminal act, as long as there is taxes that are due. Otherwise, it's simply a civil violation.

So for --

THE COURT: There is no debtors prison. They are not going to send you to jail for not paying your taxes, it just goes to another part of the facts during the trial?

MR. CLUKEY: If you fail to pay your taxes, you can be enforced in the civil side.

There could be, depending on the circumstances -- there is all kinds of factors on the criminal side. On the civil side, it's an obvious -- it's a law that everyone knows that you have to comply with that.

404(b) permits evidence to show absence of mistake, motive, intent, knowledge. And so we would be offering this evidence to show exactly that.

In addition, because this is a tax case, it's even more -- this evidence is even more -- and it's a tax case about Mr. Nagy's compliance with the tax laws, his failure to file and comply with these most basic elements is even more relevant than it would be, say, in a drug conspiracy case.

Thank you, Your Honor.

THE COURT: Okay. Thank you.

Yes, sir?

MR. COOPER: Your Honor, I think your point is correct, is you view it from how the jury will view it. It may be interpreted as being a criminal act. I mean, that is highly prejudicial.

Here, the Government is citing these criminal cases, but we have a tax case, and we are talking about him not filing tax returns. And it is highly prejudicial. It seems like the Government is not focusing on what the Statute is about.

The Statute is whether or not those documents,

Exhibits 39 through 51 of our trial list, his written tax advice, contained a statement that he knew or had reason to know it was false.

And by trying him on these tax returns is just prejudicial. It has nothing to do with the basis and the foundation of his advice. And just -- the prejudicial nature is outweighed by any benefit that would bring to the trial.

MR. CLUKEY: Your Honor, if I may clarify?

THE COURT: Sure.

MR. CLUKEY: *Boyle*, the Supreme Court case, says everyone knows you've got to file. That's a civil case. So we don't need any -- we are not trying to inflame the jury and say this was a criminal violation; we are simply talking about the civil obligation that every person knows that you have to do this. So that's really what we are dealing with.

Secondly, I believe Mr. Cooper is misrepresenting what may be shown under the Statute, and the relevant evidence under the Statute.

We had this conversation the last time we were here. Actually, that we were talking about underlying facts that may be shown in connection, the case is not limited solely to the words in Mr. Nagy's tax advice.

And in fact, you ruled in connection with Dr. Pfleiderer, that Mr. Pfleiderer may present evidence as to what a hedge is and that false statements were made in

connection with the hedge in connection with the motion in limine to exclude him.

So I think we've already covered that ground, that it's broader than it's being represented right now by Mr. Cooper.

And this evidence clearly, the fact that he was violating the tax laws, civil tax laws at the same time he was providing supposed objective tax advice to Derivium, and his claim that he didn't know that it was illegal, is relevant and not prejudicial, as those Fourth Circuit decisions also dealt with the prejudice issue.

THE COURT: So you are not going to couch his failure to file his income tax as a criminal matter, it's just he has a duty to file and he didn't file?

MR. CLUKEY: Everyone knows that civil law requires you to do this, and we would be happy to limit it to that. Absolutely, Your Honor.

THE COURT: All right.

MR. COOPER: Your Honor, I mean, I just -- excuse me, but for whatever reason, the Government lawyers who represent the IRS are treating the Statute as a broad fraud statute.

And if you read 6700, it has to be a statement about the excludability of income, the ability to take a deduction or any other tax matter.

So when you read those cases that he talks about, the fact, that fact, that was false had a direct impact on the tax benefit, inflated basis, to have false fair market value for depreciation.

The fact of a tax return has nothing to do with loan or sale. And it's much more narrow.

You look through their exhibits, it's like we are trying the Derivium trial again. They represent the IRS. It's about tax advice.

And I just can't say that enough. I feel like I'm sitting here in a general bad acts case, or whatever you want to talk about it. This is about tax advice and the Statute is narrow to that. And I believe the case law is narrow on what facts are relevant.

THE COURT: Okay.

MR. CLUKEY: Your Honor, the Statute says know or reason to know. So this is directly relevant to whether he had reason to know the statements he was making were false.

Secondly, to address -- this Court has already ruled that false statements were made. Mr. Nagy said this program was a loan. It was not a loan, as the Court's ruled, it was a sale.

Other facts that are relevant to whether this was a loan or a sale, those are -- and if there are false statements in connection with those, obviously those are

relevant, too.

So that's why, Your Honor, when you ruled that information can come in on -- that an expert can testify about what a hedge is and the fact that there was no hedge, it's obviously relevant to whether there was a loan.

In fact, Mr. Nagy, in his own deposition, testified that if there was no hedge, this could not work under the tax laws, it's an admission by Mr. Nagy. So obviously, these facts are relevant.

There is a case called *Music Masters*. *Music Masters*. It's a District Court case affirmed by the Fourth Circuit.

And one of the false statements in there is about production materials and whether the underlying recordings even existed. So those aren't even made.

So that was a false statement that was made concerning a fundamental aspect. If that didn't exist, the tax advice that was given couldn't be true.

So all of this goes to somebody that knew or had reason to know. If there are a number of statements that they knew were false, that goes to whether they knew or had reason to know the tax advice given was false.

THE COURT: Okay. Thanks.

How about Mr. Cohen?

MR. COOPER: Your Honor, it's relatively simple.

The cutoff was July of '09. He was disclosed, I believe, sometime in October or November of '09. He's from the Brattle Group, it's a well-known litigation support group. He's an expert coming in to produce documents that wasn't disclosed during discovery.

MR. CLUKEY: Your Honor, this Fourth Circuit decision we cite in our brief, it's *United States vs. Dukes*, that's a 2007 decision.

There, it was a -- the case involved criminal mail fraud. And the relevant issue there, there were summary records, bank records that were made, summaries.

First, before I get along any farther, let me say, first of all, Evan Cohen is not going to testify as an expert. He is simply a summary witness. He's only being offered as a summary witness. He will not present any expert testimony.

But this case in *Dukes*, the Government disclosed weeks -- just a few weeks before trial, they disclosed the existence of a person who was going to testify about the summary exhibits. And then they prepared the summary exhibits and produced those five days before trial. They also prepared summary exhibits as the trial was going along and produced those during trial.

In that case, where it was actually a criminal matter where the stakes were even more severe, the Fourth

Circuit said that that was not -- that that was acceptable, that wasn't, um, those summaries would not be excluded.

In our case, we -- Evan Cohen was disclosed six months ago; not weeks ago. He was disclosed six months ago. He will not testify as a fact witness. He will not testify as an expert witness, simply as a summary witness.

Secondly, the documents that he's testifying, that he's summarizing, were produced to Mr. Cooper, or to Mr. Nagy during the discovery period more than a year ago. Some of the documents he's summarizing were actually Mr. Nagy's own billing records which were produced to us, and then the summaries were produced more than two months ago.

So under this authority of *Dukes*, these should not be excluded. They were provided in plenty of time, and there is plenty of time for -- for Mr. Cooper to look at the records, prepare his own summaries.

THE COURT: All right.

Yes, sir?

MR. CLUKEY: I'm sorry. And he has done that, actually.

THE COURT: Okay.

MR. CLUKEY: Thank you. So it's not an expert witness, but --

MR. COOPER: Nothing comes to mind, Your Honor. Maybe they'll trade with me, Cohen for Kern.

MR. CLUKEY: No chance.

THE COURT: Thank you for your candor.

All right. I think the last one -- and there may be some other ones we need to talk about -- is the renewed Motion to Bifurcate.

MR. COOPER: Yes, Your Honor.

I'm just again going to plead with the Court to bifurcate this court -- matter.

I think one of the problems we've seen is the objections to the hearing transcripts. They are looking to introduce testimony from the Derivium trial that was before Your Honor. Mr. Nagy was not a party to that, so it's hearsay under the Rules.

And the prejudice that would cause -- and if you -- if you look through the exhibits, that Mr. Debevc's role was completely different.

And I think Your Honor's comments, too, were rather enlightening in the other hearing saying, you know, Mr. Debevc was someone totally different than Mr. Nagy in the underlying facts in what they did. And it just causes confusion in fact.

I think if you tried Mr. Nagy's case without Mr. Debevc, it would probably reduce the Government's 350 exhibits to something far less.

So we would ask that you bifurcate the trial, on top

of Mr. Nagy being in trial with a person that is -- was an owner from Derivium and had a whole different set of knowledge than Mr. Nagy.

THE COURT: Who do you want to go first?

MR. COOPER: Your Honor, I'll go first.

THE COURT: I just wanted to let you know, I didn't know whether you were throwing Mr. Debevc under the bus or you were going to go under the bus first.

MR. COOPER: If he wanted to go first, he can go first. We'll draw straws.

THE COURT: What a gentleman.

Yes, sir?

MR. CLUKEY: Mr. Cooper raises a fair point. We offered a single witness who only goes to Mr. Debevc, that is true, 16 witnesses go to both.

So we have a witness, Laura Harrison, we had hoped that she might be able to actually come and testify at trial, but she's due -- she's pregnant and she's due now, and so she couldn't -- she can't make it.

THE COURT: Is she from Jackson Hole?

MR. CLUKEY: Yes. And she did testify in Campbell, in the Campbell case.

And we believe that that testimony would be admissible, and we'll seek to admit it against Mr. Debevc.

We understand if Mr. Nagy would like a limiting

instruction as to him, it doesn't pertain to him whatsoever, but the rest of the 16 witnesses address facts we believe both Mr. Nagy and Mr. Debevc were aware of and knew.

And Your Honor, the -- the only thing I would say is you've already ruled on this motion twice. We don't believe any other facts have changed in this case.

THE COURT: Okay. What do you think, Mr. Debevc?

MR. DEBEVC: Your Honor, I did not file a brief on this, but I do respond to the opinion which was expressed earlier for severance of this trial. Because in fact, we are two different people.

On one hand, Mr. Nagy is a professional that generated tax opinion. On the other hand, I was the end user of those tax opinions, or those briefs or memoranda.

And to suggest by any special imagination that I have intimate knowledge of tax matters as, with my limited education, I think that is really going -- um, that's stretching the imagination. And again, I feel that myself being, again, thrown under the bus, as you so eloquently said.

So I think I would be in favor of separating the two trials because the -- as I think the evidence has shown, and discovery has shown to this point, that the fact that the two cases are dissimilar. And I know that some of them, but the two cases are dissimilar, one being the end user of the tax

memoranda, which is by professionals, and the actual entity that produced this tax professional in-depth field.

THE COURT: Okay. Thank you. Anything else?

MR. CLUKEY: No, Your Honor.

MR. COOPER: There was two other. Don Hancock is also the trial testimony.

MR. CLUKEY: Your Honor, we've withdrawn that. We are not going to offer any testimony from Hancock.

MR. COOPER: What about Mr. Scrantom? He also -- they tried to take him in Nagy's injunction case in California, realizing that they couldn't use his deposition testimony in the bankruptcy matter. That deposition was never completed. So they are using Mr. Scrantom's testimony. It's also -- Mr. Nagy didn't have the opportunity to cross or develop examination in that, as well.

MR. CLUKEY: Actually, Your Honor, Mr. Nagy's counsel, Fleet Freeman, attended the entirety of that deposition.

So Mr. Nagy was actually represented. He was being sued by the Trustee at that time for another cause of action. So his attorney did show up and is on the record in that deposition, and we can show that.

MR. COOPER: Well, but he -- it wasn't his case. He wasn't able to cross-exam. And I can bring in Fleet Freeman to that extent, but the testimony was not developed in that

case because, as he pointed out, Mr. Nagy was in a different lawsuit.

THE COURT: All right. Where is Mr. Scrantom nowadays?

MR. CLUKEY: He's in New York, London and Wyoming, my understanding.

THE COURT: Undisclosed location.

MR. CLUKEY: That's right.

THE COURT: Okay. All right. Anything else?

MR. CLUKEY: Yes, Your Honor. There are a number of pretrial matters that we would like to address.

THE COURT: All right.

MR. CLUKEY: If that's okay.

THE COURT: Shoot. Why don't we address who is going to be first.

MR. CLUKEY: That was our first item.

THE COURT: You both want to go first. That's impossible.

MR. CLUKEY: Yes, it is, Your Honor.

And if I may, I'll give you argument why we think the United States should go first.

The United States has the burden of proof as to -- as to the 6700 conduct. And at some point in time -- this is in our pretrial brief, but it might be in the jury instructions, as well -- but there is an issue as to the

amount of penalties and who has the burden of proof as to that.

The core issues in the case, the United States has to prove that both Mr. Debevc and Mr. Nagy knew or had reason to know that they violated Section 6700. Because we bear the burden of proof, and we have 17 witnesses who will go on at trial, we believe the United States should go first on that issue.

The second thing is, this is a fairly odd statute, in that it provides a mechanism for people who have had penalties asserted against them to not pay the entire penalties, to get into Federal District Court and challenge these penalties, you only have to pay a very small amount, so both Mr. Nagy and Mr. Debevc pay just a couple thousand dollars to get here.

The United States is also a counter -- is countersuing them. So we are a plaintiff in that sense, or a plaintiff for far more. We are a plaintiff for 2.7 million against Mr. Nagy, and we are a plaintiff against Mr. Debevc for 3.3 million.

So given the fact that we are in a plaintiff's posture, given the fact that we have the burden of proof as to most -- as to the most -- the most serious conduct, or the biggest issue before the Court, we believe we should go first.

And the last thing I'll say, if we fail to meet our burden of proof, of course the plaintiffs here could seek for a directed verdict and save everyone time.

Thank you.

THE COURT: Yes, sir?

MR. COOPER: Your Honor, I would -- when I was looking at this, I looked at Local Rule 83, Roman Numeral 604, and the Local Rule of the Court says: "In the trial of a civil action, the plaintiff shall" -- excuse me, my eyes -- "shall open and conclude the testimony and the argument."

I think the Local Rule says we go first. We are the plaintiff. The procedure to get here, I don't think is real relevant. And in fact, District Court was our only venue. With 6700 penalties, you don't get to go to tax court, you have to come before Your Honor.

Mr. Nagy wrote this tax advice and the Court has broad discretion on how to conduct a trial before it. It's in your courtroom. We would ask that Mr. Nagy be able to go up first and to explain to the jury why these assessments the IRS made are incorrect.

THE COURT: How is the jury going to understand anything? I mean, you are trying to prove a negative at that point, aren't you? I mean, they don't know anything about anything. I mean, they don't know what a 6700 penalty is. They don't know nothing.

MR. COOPER: That's my job in opening statement. That's my job in how I present the evidence to the jury. And it's my job to make them understand that Mr. Nagy gave advice he believed was very good.

On top of it, we do have two scheduling issues, Mr. Brandenburg, we've had a subpoena on him, has scheduled a family trip with his family that Friday, the date alludes me, I think it's the 22nd through that next Tuesday. So we would want to go first and get him in. And also Mr. Kern is scheduled to be in Italy the first Monday.

So in order to conduct a trial, we would ask you to take that into consideration, too. But we don't believe it's proving a negative; we believe it's proving that he believed this tax advice.

MR. DEBEVC: If I may, something from just a common sense perspective.

I think, just generally speaking, I understood when people go to court, it's the United States Government, the assumption is it's the United States Government that brought the action against the individuals.

In this particular case, we the individuals brought the suit against the Government for not following their own rules. And this trial is the evidence, from being something of that the United States Government could take a look at the Complaint that I filed, it was that the Government did not

follow its own written rules. And that was the only venue for open to be challenged at was the Federal Court.

It now seems that the tables have been turned. That the United States is, for all intents and purposes, retrying this case, whether the 90% Stock Loan Transaction was a sale, was a loan, it's what made it into a tax matter, which I think that -- I think the -- that's why I think it would be important that we go first and lay the groundwork for the jury as to how we find ourselves in this position to begin with.

THE COURT: Okay. Thank you.

Yes?

MR. CLUKEY: Your Honor, Mr. Cooper said you have discretion, obviously. Not withstanding the Local Rule, Fourth Circuit case law confirms that discretion.

And we believe it's just -- it makes a lot more sense to have the Government go for the reasons I already stated.

But just for the record, we have scheduling issues, as well. We have scheduled every single one of our witnesses to be here on time. Our first witness has a number of scheduling issues, and there is only a single day that he can come, and we are having him the first person. He's opening, going on that day. And our expert, Dr. Pfleiderer, has quite a number of conflicts.

So whoever goes first, whoever doesn't go first, is obviously going to have some issues with scheduling.

Thank you.

THE COURT: It sounds to me like Mr. Cooper's witnesses have scheduling -- more scheduling problems if he goes second than if he goes first.

You are saying your man's got a problem, has to testify on Friday, or he's going to be out of town Friday or the next Tuesday or something like that, right?

MR. COOPER: Yes, Your Honor. Mr. Brandenburg is from Friday until that next Tuesday.

THE COURT: So that's Friday the first week until Tuesday the second week?

MR. COOPER: Yes, Your Honor.

And then Mr. Kern, that next month after opening statements, goes to Italy for several months.

MR. CLUKEY: Your Honor, and if I may offer two people? One, we are -- we've obviously moved to exclude Mr. Kern, so that may be a moot issue.

Second, we would -- there is no way that Mr. Brandenburg can testify -- we wouldn't be necessarily averse to having him go in our case in chief, if that was the only accommodation that could be made.

And actually, I would like to address one last thing. Assuming that, Mr. Debevc said a minute ago, and it

was about what the case is about, to make sure Mr. Debevc understands, he had a second cause of action in this case, but he was alleging the United States had done -- had not followed the rules and not been -- that action was dismissed.

Mr. Debevc mentioned this cause of action during voir dire to the jury. We would like the Court to instruct Mr. Debevc that he cannot mention that to the jury during his opening statement because it is not an issue.

THE COURT: Okay.

MR. CLUKEY: Thank you, Your Honor.

THE COURT: Mr. Debevc, I think they are right on that one, okay?

So when and if -- when you get to trial, remember that, okay?

MR. DEBEVC: I'll do my best.

THE COURT: All right. I know. All right.

MR. DEBEVC: Your Honor?

THE COURT: Yes.

MR. DEBEVC: May I say something else?

The Government has moved to -- actually argued to exclude the testimony through the positionings of Mr. Cathcart and David Lancaster. Those are my witnesses. And I believe that they should be included for an assortment of reasons.

One, because they are -- the Government argues on

one hand that if I knew or had reason to know. And the testimony in those depositions clearly suggest as to who knew what and when did they know it.

And also, that there is a -- also, according to the Rule 803(8) and (14), that -- I think that it is important that that -- those -- that testimony be admitted.

MR. CLUKEY: Your Honor, we refiled an objection to it. We hadn't moved to limit that, but we certainly filed an objection regarding Mr. Lancaster's testimony.

Mr. Lancaster testified in 2004 before a -- the California State Board of Corporations, and the United States did not participate, it was a state action. The United States was not a participant. It was before the United States even brought this 6700 action.

And at that time in 2004, the full extent of the false statements and fraud by Derivium Capital was not known to anyone.

And so Mr. Lancaster's deposition not only did we not have a chance to participate in that, but the facts were -- the facts were materially different and the scope of the fraud, the extent of the fraud, was not known to the world at large at that time.

MR. DEBEVC: Your Honor, I believe that the Statute states that this is a public record. And the report -- this is a public record in the report. It was filed in the state

court, specifically to Mr. Lancaster's testimony. So it is available. It is a public record.

Then if nothing else, then it should be -- should be allowed to use his statements to show that, number one, that these statements exist, not necessarily even if it is not for the reasons that the veracity of those statements. However, this was a deposition taken from the report and it is a public record; and therefore, it should be admitted.

The same thing goes for Dr. Cathcart's testimony. They are public records. And they -- Mr. Lancaster's position as vice president of marketing will shed light on -- sheds light on my participation in marketing, which was nonexistent.

THE COURT: All right.

MR. CLUKEY: Your Honor, I don't know what your agenda is as far as going through, but we had a couple of other items.

THE COURT: I'm going to -- first we are going to clear a couple of things up, and then we'll go forward, okay?

MR. CLUKEY: Yes, Your Honor.

THE COURT: I think the Government has the burden of proof. The Government can go first.

The defendant -- now Mr. Cooper, what is your position with regard to the shifting burdens? You didn't address it in your pretrial brief. Doesn't the burden shift

to you as to the amount of penalties, or are you even going to go there? I don't know whether you are going to litigate the amount of penalties, or if he's found -- or if that is going to be a subject of the trial, I don't know.

MR. COOPER: The burden on the penalties is, my reading of the Statute, is they have all the burden.

I know there is some Second Circuit law that they pointed out that said that it shifted to me. I think those courts did a little too much slicing and dicing of the Statute.

It says that the Government has the burden of proof of liability. When I read the word "liability," it means you've got to prove they did something wrong. You've got to prove how much it is.

So I would just ask this Court not to follow the Second Circuit on that.

So it's my position they have all the burden.

THE COURT: Maybe that's even better because then if they've got the burden of proof about everything, then they ought to be first.

MR. CLUKEY: Your Honor, we believe that the decisions that have concluded that there is this burden shifting are right for this reason: The Government's not in possession. We don't know how much -- how much money these individuals actually made necessarily in connection with

this -- with this scheme.

The way the tax law normally works is the -- is that taxpayers have the burden of proof to show how much money they actually owe, which is the the normal burden of proof.

This is a special Statute that when you have promoters of a tax scheme, the Government -- the Congress put the burden of proof with respect to the false statements themselves and whether the parties knew, promotors knew or had reason to know these statements were false. And so that's on the Government. And that's clearly in the Statute and that makes sense.

As far as the penalty amount -- and by the way, those cases are typically litigated in injunction actions, which we did litigate. There are a whole host of reasons why this case came out the way it did, which I don't have to belabor the Court with.

But ordinarily, the taxpayers have the burden of proof to show how much income they are -- those cases that have looked at 6700 and have -- and have actually looked at this issue when it does come, it -- and it doesn't come up that often, but when it does, it says that the burden shifts for that long held rationale, if you make money, it's the taxpayer that controls their own books, they control their own records, they know how much money they have, deductions they have, etcetera. So that's this long-standing rationale

ground for that.

THE COURT: All right. We'll have to look into the burden shifting because we didn't find anything that you addressed in any pretrial papers. So we will have to take a look at that, okay? So I can't make a decision.

Assuming that there is burden shifting, okay? Then first, second, third, and any rerebuttal, which would make it four, if you have something on rebuttal, because we are actually trying two cases perhaps, burden, burden, anti-burden, anti-burden. Do you see what I mean?

Assuming you have the burden to prove the amount of the penalties, then they would rebut what you did and then you would get a chance to reply to their rebuttal if you wanted to, and then -- or until the jury fell out of their chairs asleep, whichever comes first, all right?

So if you have the burden because of the burden shifting, then I'll give you a chance to do a reply to their rebuttal, okay?

MR. COOPER: Thank you, Your Honor. I don't think I have ever filed a sur reply.

THE COURT: There's a first time for everything.

MR. COOPER: Thank you, though.

THE COURT: But we'll have to look. And if you can find any -- if you can give me some authority about that that you don't have -- I mean, there is a Second Circuit case,

which is a circuit court case, which is -- it's the only thing out there, I'll probably follow it. If there is something else out there that says that's wrong, or something in the Fourth Circuit, I'll take a look at it. All we've got is the Government's position with regard to the burden shift.

MR. COOPER: I'll try to make your job easy. I have looked in the Fourth Circuit, I haven't found anything.

THE COURT: You haven't made my job easier.

MR. COOPER: Well, Frank, I'll just ask you to look at the Statute.

THE COURT: So if all we have is a Second Circuit, and the Second Circuit says there is a burden shifting, then you might want to be prepared.

MR. COOPER: Understood. Thank you.

THE COURT: Okay? Because they may not be direct bosses, but they are my indirect bosses, who my direct bosses haven't said anything, okay?

All right. I'll look at the 803(8) Mr. Debevc brought up with regard to Mr. Cathcart and Mr. Lancaster's testimony in the State of California, which the Government was not a party to.

MR. CLUKEY: Let me clarify with respect to Mr. Cathcart, Your Honor, he was deposed in this case. We made some objections to certain, I guess some hearsay and that type of thing.

So in case Mr. Debevc was confused, we are not objecting wholesale to the introduction of Dr. Cathcart's testimony; just Mr. Lancaster's.

THE COURT: Okay.

All right. Yes, sir?

MR. COOPER: Just for scheduling purposes, Your Honor, what can I tell Mr. Brandenburg? Will we try to fit him in, if necessary, if the Government is going to go through Thursday?

THE COURT: Okay. Well, I have to be in Richmond on Monday, the Chief Judge's conference, so there will be no court Monday. So he'll be back Tuesday, so it will fit right in, it would seem like to me.

MR. COOPER: Okay. When you said -- you said you go very fast. I don't want to get until Tuesday and have it already gone to the jury or something.

THE COURT: No, I won't do that. You find out what his schedule is. He's leaving town on Friday or leaving town on Thursday, or what is his --

MR. COOPER: He's available Thursday but not Friday.

THE COURT: Okay. Then he's available Tuesday?

MR. COOPER: Yes, Your Honor, that's my understanding.

THE COURT: Okay. And so you've got -- all right. I will not go to the jury without you being able to call him.

And it will probably be, more likely than not, from what everybody says, the Government's case is going first, is going to last most of next week, if not all of it.

Will he be your first witness or where does he fit in?

MR. COOPER: No, Your Honor. He's not the first.

THE COURT: So if the Government finished Thursday, you have plenty of things to do Friday, and then you can call him Tuesday.

MR. COOPER: I tend to be more brief, though, so I don't know.

THE COURT: If we have to end up early on Friday, which nobody has ever complained about, especially the jury on Friday afternoon, then we'll just start on Tuesday with him.

MR. COOPER: Thank you for the accommodation.

THE COURT: So more likely than not -- I mean, I don't know, John Kern, assuming he testifies, is gone, leaving --

MR. COOPER: Monday.

THE COURT: This coming Monday, like three days from now, or a week from Monday?

MR. COOPER: Ten days.

THE COURT: So he would be available late next week if you are allowed to call him.

MR. COOPER: Yep, Your Honor, he would.

THE COURT: All right. Got you.

All right. What else?

MR. CLUKEY: Your Honor, do you have any time limits for opening statement? I guess we just ask, opening and closing statements, just so we know.

THE COURT: Um, 37 seconds in opening, a minute and a half in closing. No, I don't --

MR. CLUKEY: What about --

THE COURT: Y'all have tried a lot of cases. It's them, you know. I mean, I'm a professional, I can sit here forever, but you know, there is the point of diminishing returns.

But also -- but I do have rules that you can't use anything in your opening that you do not know is coming into evidence, so that's --

MR. CLUKEY: That was my next question.

THE COURT: So if it's going to come into evidence and everybody agrees it's going to come into evidence, mark it in evidence and you can use it in your opening. If there is a dispute about it, you can't use it.

MR. CLUKEY: I presume you can't reference it, either, can't use it, can't reference it?

THE COURT: You know, you take a risk. I mean, you can if you want to. If you promise the jury something, that

they are going to see X, and X doesn't come in, then that's up to you. That's your problem; not theirs. I mean, so -- but that's the lawyer's skill.

MR. CLUKEY: Right.

Your Honor, we just received another exhibit from Mr. Cooper. It looks like -- I don't know if -- know if this is right or not, but how I interpret it, it's got the prior penalty amounts.

The Government has now conceded one year, the first year that the penalties were assessed in 1997. We've also recalculated the penalty for the end of 2004 and 2005. And as it has been ruled on a couple of times, this is a de novo proceeding, and we don't believe the original penalty amount was relevant.

The jury is going to be able to calculate the penalty and see what penalty is appropriate here. And so we are not sure what relevance it would have. And I'm just teeing it up now in case it comes up during the opening.

THE COURT: I wouldn't refer to it unless you know it's going to come in evidence, and then we can argue whether it's going to come in evidence or not, and you can argue about it in closing when you know whether it's in or out, okay?

All right. Anything else, Mr. Clukey, Mr. --

MR. CLUKEY: Yes, Your Honor.

We have as our -- so I -- we have all the exhibits here, and I presume you don't want to go through all of these right now because there are quite a lot of them -- we have sort of a local issue.

We are intending to present as our first witness, if we have to do so, Andrea St. Amand. She is with the law firm of Nelson Mullins. She oversaw document discovery in the *Campbell* case, and there were a number of 901 authentication objections to documents that we know came from Derivium's files that Mr. Debevc had control over. So there are quite a few 901 objections, and as well as agents of Derivium, like some of Tim Scrantom's -- a couple of Tim Scrantom's documents, for example.

So they are 901 objections. She's got to come in, and in our view, it's a waste of the jury's time, but we are going to go through the motions, if we have to, to present her to testify how she got all of the documents and where they came from, just as sort of a global authentication witness.

We are not sure if that's actually necessary. And I was actually trying to tee it up with Lindsey Cooper before you came out on the bench.

THE COURT: Okay.

MR. COOPER: I don't quite understand what he's asking. I'm sorry.

MR. CLUKEY: Is the authentication of these documents an issue?

MR. COOPER: Some of them.

There is like some e-mails where you can't tell where they come from. And none of the people, my understanding of, will be testifying at trial to be able to authenticate them. So we made the appropriate objection if we need to.

MR. CLUKEY: The e-mails came from a Canadian server. And I know you heard about that during the *Campbell* case. It's a server that Derivium Capital purchased in Canada.

So those documents would be outside the possession of the U.S. So Ms. Saint Vincent was in charge, tasked with getting those documents and getting the information on the server.

So we'll present her at trial if we have to, but we don't believe it's a valid objection.

THE COURT: I'm not hearing you. You want Ms. Saint Vincent to come up and authenticate some or all of these documents?

MR. COOPER: Well, if I made an authentication objection, Your Honor, there is -- I suppose I have to think about it because --

THE COURT: I was going to stop you in about

15 minutes and let y'all talk about it.

MR. COOPER: Okay.

THE COURT: Because I was going to go up and talk to my posse about these other rulings and then we'll come back down and we can take care of the rulings, and you can take care of some of the documents. It would be an appropriate use of time.

And if you've got any documents that are particularly viable that you may want to use in your opening, you can tee it up and see if I can rule on it. If I can, I will. If I can't, I won't. I've got all afternoon.

MR. CLUKEY: Thank you, Your Honor.

THE COURT: The more we do today, the less we have to do early in the morning, okay?

All right. Thank you. We'll start again -- I'll be up in my office until -- y'all just tell Gail when you are ready and I'll come back down then, okay?

(Thereupon, there was a brief recess.)

THE COURT: All right. I just looked at my schedule now. If we are productive, you know, I've got all afternoon tomorrow, starting at 10:30 tomorrow morning, if you want to come back and do some of these things, because we have to do them when the jury is not here. We can do them tomorrow afternoon, we'll do them at 9:00 in the morning, you know, good time to start. As they say, a journey of a thousand

miles starts with the first step. And I'm ready to go whenever y'all are.

What's the upshot of the 901 and Saint Vincent and all that?

MR. COOPER: With Saint Vincent, whatever they've explained to me, whatever the Trustee sees in the Derivium warehouses in the Canadian server, we'll agree to the authenticity to all that.

THE COURT: We don't need to call her as a witness?

MR. COOPER: I think there was one in the Isle of Man.

MR. CLUKEY: I thought we -- just the conversation that we just had, I think there were only a few documents from the Isle of Man that we actually want to introduce. And those documents were actually discussed with deponents in the Isle of Man. I thought you just said those documents you wouldn't have an authenticity objection.

MR. COOPER: If the witnesses authenticated them, that's fine.

THE COURT: Are y'all using the same videotape depositions or are you using your own?

MR. CLUKEY: Yes, sir.

THE COURT: I remember in the trial, Mr. Debevc can correct me, they had the Isle of Man people on videotape and they used some documents and flashed them back and forth, I

think. So if there is no authentication problem with those -- they are I.D., I guess, right?

MR. COOPER: That's correct.

THE COURT: Okay.

MR. CLUKEY: And Your Honor, a related question to that, for the video depositions, how do you deal with the exhibits? Can the jury see the exhibit while they are testifying on video or how does that --

THE COURT: You mean mechanically?

MR. CLUKEY: Yes.

THE COURT: It's above my pay grade. I don't think so, no.

MS. WEIS: I think the actual issue is for exhibits that the witness is going to be describing in the video that haven't been admitted into evidence yet, if they are shown in the video, we want to avoid, obviously waiving any publication issues, but we also don't want to keep having to pause the video, unless that's the preference of the Court, to move in the exhibits as they go.

THE COURT: I mean, if Mr. Cooper is satisfied that the documents have been identified by the witness on the videotape, you can go ahead and just mark them into evidence, because -- is that what your understanding is, Mr. Cooper?

MR. COOPER: To move them in above without any objection, yeah.

THE COURT: So you have other objections?

MR. CLUKEY: To some of the documents, yes, there is some other objections.

THE COURT: All right. So I mean, we can make it run smoothly. If you've got those and you want to bring those in tomorrow, and I can take a look at the, you know, testimony and rule on your objections, which will make it -- how does that sound?

MR. CLUKEY: Sounds great.

MR. COOPER: That sounds fine.

The one thing is that was a little bit difficult in the documents, I was trying to link them between how they are described in their exhibit list to how they are in the deposition transcripts. So if the Government could help me out with what exhibits are going to be with what witnesses, that would be much appreciated.

THE COURT: I mean, y'all can meet this afternoon until about 10:30 tomorrow morning and then tee it up after that, and go as far as we can go. How does that sound?

And anything on the other side, too, I don't know your exhibits. I mean, did they -- do you have an objection to his or we can do that for everybody?

MR. COOPER: Yes, Your Honor.

THE COURT: Yes.

MR. DEBEVC: I'm just standing up.

THE COURT: That's no problem.

MR. DEBEVC: I totally forgot. I was doing this as a spectator; not a participant.

THE COURT: Okay. That's fine. No problem.

Anything else? Yeah?

MR. COOPER: Is it okay if Ms. Van Bavel sits with me during trial? She's a paralegal in my office.

THE COURT: Sure. Identify her and let the jury know who she is, okay? They might think she's your guardian or something.

MR. COOPER: I need one.

THE COURT: I understand that. Don't we all? Okay.

MR. CLUKEY: We have a couple of additional issues.

THE COURT: Okay.

MR. CLUKEY: One, we put this in our pretrial brief, Mr. Debevc, in how he testifies. When he's actually testifying in his case in chief, we requested that he be required to testify in the question and answer format, just so that we can preserve the record and so he doesn't have a long -- and gets into hearsay and we can't object. I don't know how the preference is for dealing with that.

THE COURT: Never happened before, um, so -- I actually have had it in a criminal case, a criminal tax case, as a matter of fact, pro se also, all right?

Mr. Debevc, how do you anticipate providing

testimony to the jury?

MR. DEBEVC: Actually, I was looking to the Court for guidance because I was sort of wondering myself. Do I ask myself in the mirror, Mr. Debevc, how do you come to this? I don't know what the protocol is. And so I was wondering myself, how do I effectively put the information into the hands -- into the Court and to the jury?

THE COURT: Okay. Perhaps it would be good to sit down and think about an outline of the subjects of which you are going to testify about, okay?

MR. DEBEVC: Yes, sir.

THE COURT: And then provide that outline to the Government and see if they are going to object to any subjects that you are planning on testifying about.

And if they are not, then you can tell the jury, this is about this, and this is my testimony about this. I mean -- because I mean, like the Government pointed out earlier, the thing about the due process and not following -- that's not in your case anymore because it was dismissed about a year and a half ago.

But if we -- and the reason for that is, is because, you know, it was easier last time because you had your lawyer lead you through it, and everything like that. Um, you know, but it makes it hard for the Government to object when you are in kind of a narrative. And it's not good for the

Government, it's probably not good for you, because if they object, I sustain your objection, then the only remedy I would have is to strike your testimony as to that issue. And that would not be good for you.

So you see what I'm talking about?

MR. DEBEVC: I understand.

THE COURT: Do you think you can do kind of an outline of what the issues are, give it to the Government? And the good news and the bad news about my ruling is you get to go second, so you get to think about what you need to talk about and what areas that you need to talk about, okay? And then I can decide whether, you know, this is my testimony as to this issue, and do it on a narrative, or do it on a question and answer basis.

MR. DEBEVC: Understood. So I'll try to prepare an outline and I'll share that.

THE COURT: How does that sound, Mr. Clukey? That's one step at a time.

MR. CLUKEY: That sounds like a good first step, Your Honor.

THE COURT: It may be that you get to do a narrative on certain issues and maybe you have to ask yourself questions, and I'll explain to the jury that this is because you are your own lawyer. It seems a little awkward, but this is the only way we can do it, to be consistent with

everything else in the trial, because everyone else is answering questions by a lawyer, okay?

MR. DEBEVC: Understood.

MR. CLUKEY: Thank you, Your Honor.

Then materiality and falsity, we believe that those issues were addressed indirectly by virtue of your summary judgment ruling. And so we also put that in your pretrial brief.

We believe that the ruling that the entire program wasn't a loan, and obviously, the entire program was being held out as a loan, not a sale, that that would be material. It's also in our jury instructions, as well.

THE COURT: Materiality and what?

MR. CLUKEY: Falsity, which we think is a necessary -- so there was sort of a necessary implication of the fact that they said it was a loan, and in fact, it was a sale, tax laws.

And then also the plan, that this was a plan. That's one of the elements that it has to be a tax, you know, falsity in connection with the promotion of a plan.

THE COURT: All right. Is it -- Mr. Cooper, is it an issue as to planned materiality and falsity? Falsity I understand probably is.

MR. COOPER: Falsity is definitely an issue. I mean, you ruled that it's the law of the case. But

obviously, we are going to look to when the ruling was made and what other law is out there on the issue.

So even though you ruled, we respectfully disagree, obviously, but it is the law of the case, so we have an issue with that.

THE COURT: Okay. Materiality?

MR. COOPER: Materiality, I think they would have to prove that that advice was material of the decision.

Because as Mr. Debevc I'm sure will testify, a lot of these folks for a lot of other reasons, buying insurance, simply diversification, so the tax aspect may not always be material.

As far as there being a plan of arrangement, there is one.

THE COURT: So there is no issue as to plan, so you don't have to worry about proving plan.

MR. CLUKEY: Your Honor, just for materiality.

MR. COOPER: In fact, we would almost be willing to concede the first part of the Statute that Mr. Nagy participated in it and keep the issue focused on whether his tax advice was false or fraudulent, because that's what it boils down to.

MR. CLUKEY: Participation, Your Honor, what he's trying to do is eliminate circumstantial evidence. That goes to whether he knew or had reason to know. So we would

stipulate to that.

THE COURT: It takes two to stipulate. So that's all right.

MR. CLUKEY: We've got a quote here, and this is from our pretrial brief, to prove materiality, quote, "the Government need not demonstrate that a purchasing taxpayer has relied upon the purported misrepresentation." That's *U.S. vs. Ratfield*.

And then we also have whether a scheme's customers used this misinformation to violate the tax laws.

THE COURT: What page of your pretrial brief?

MR. CLUKEY: Page 12.

THE COURT: All right. I just wanted --

MR. CLUKEY: So then, "Thus, further the scheme's customers use that information to violate the law is irrelevant, and Congress intentionally omitted taxpayer reliances as an element of the offense."

That's *Estate Preservation Services,* the leading case on 6700.

THE COURT: Okay. So assuming that I buy your argument that I've already decided materiality, falsity and plan is not an issue, what do you propose to do?

MR. CLUKEY: We don't have to prove those elements at trial, so --

THE COURT: How is the jury going to figure that

out?

MR. CLUKEY: Well --

THE COURT: It's part of the charge.

MR. CLUKEY: Hopefully through the jury instructions. We would like to be able to mention it at trial, as well.

THE COURT: All right. You propose that if I buy your argument that the closing instructions will be the Government has to prove the following elements, one of the elements, materiality, the Court has already determined that these statements were material, the Court has determined that this is a plan, the Court has determined that this was false in the jury instructions as opposed to at trial?

MR. CLUKEY: Yes, Your Honor.

THE COURT: Okay. It's not preventing you from saying it in opening statement or anything else.

MR. CLUKEY: Yeah.

THE COURT: Okay. I'll look at page 12 again, because I can let you know tomorrow if you are coming back in here.

MR. CLUKEY: Thank you, Your Honor.

And there is actually, if it's okay, I would like to brief one exhibit today.

THE COURT: Sure.

MR. CLUKEY: There is a McDermott Will & Emery

opinion that we believe is rank hearsay, and --

THE COURT: As opposed to regular hearsay?

MR. CLUKEY: Thank you, Your Honor.

THE COURT: As opposed to not smelly hearsay, as opposed to rank hearsay?

MR. CLUKEY: It's an opinion, a tax opinion that was not prepared for Derivium, it was prepared for others, and Derivium somehow got a copy of it. And it pertains to a different scheme. I mean, it looks like -- it's like a similar scheme.

THE COURT: Um-hum.

MR. CLUKEY: But Derivium didn't get anything from McDermott Will & Emery on anything. I've actually got evidence that will be introduced at trial on that.

And that actually, Mr. Debevc and Mr. Nagy both admitted in depositions that McDermott did not give Derivium a legal opinion saying that this scheme is okay.

So we want to avoid any mention of that in the opening in particular.

THE COURT: Okay.

Yeah?

MR. COOPER: Well, it is a tax opinion, and it goes directly to Mr. Nagy's state of mind. It was written by a large law firm. He received it from his client. He kept it in the ordinary course of business, and it goes to what he

believed the basis of advice was correct.

THE COURT: Okay. How about give me a copy of it? You don't have to do it today, you can give it to me -- fax it or e-mail it to Frank or something like that, okay?

And if I understand Mr. Cooper correctly, what you are going to do is, is going to through Mr. Nagy, say, I had this opinion from McDermott Will & Emery, and they weren't our lawyers, but I had this opinion from them, and it said that some -- it doesn't mention the Derivium scheme, does it?

MR. COOPER: It mentions a 90% Stock Loan transaction that was sold by a qualified advisor that did sell Derivium stock loan. He just rebranded it as something called stock to cash and --

MR. CLUKEY: Your Honor, that's --

MR. COOPER: Can I finish?

That the front of it is a Derivium memo letterhead from David Lancaster, who was the marketing person for Derivium, to Mr. Nagy, and he received it in the ordinary course -- it was in his business files.

THE COURT: Okay. What year?

MR. COOPER: 2001, Your Honor, before the IRS audit.

THE COURT: And what -- what year is -- are his opinions, which are 39 to 51, I believe you all said earlier.

MR. COOPER: His opinions on the 90% started December of 1998. They think it's '97. We say '98

through -- I think his last opinion was that January '05 opinion.

So it was given to him during right before the IRS audit when he was -- because what happened is he started offering opinions from '98 to 2002 and he was pretty active and then he stopped.

And then during the California Franchise Tax Board investigation, he wrote defensive opinions. So they were just sort of regurgitations of what was going on.

So it was definitely something -- what he was writing at the time, he was looking at it and comparing what his basis was, as compared to what other lawyers were doing.

MR. CLUKEY: Your Honor, the -- I'm sorry for interrupting.

The cover page that Mr. Cooper just referenced is simply a cover page, not from McDermott to Derivium, it's from one of the marketing people at Derivium. It's somehow -- it's not a cover page, it's a separate document.

THE COURT: That's what he said, it was from Mr. Lancaster.

MR. CLUKEY: Right.

So McDermott communicated nothing to Derivium.

So in order -- and actually -- right. So we have -- so in addition to hearsay, we also have an authentication objection to the document. There is no indication at how

anybody got this, how Mr. Lancaster got it. There has been no testimony from anybody at McDermott about this -- about this document. And from the face of the document itself, the information that Mr. Cooper just said about how it's a spinoff, none of that information is inherent.

THE COURT: Why don't y'all just e-mail it tonight and I'll take a look at it and we'll talk about it tomorrow.

MR. CLUKEY: Thank you, Your Honor.

THE COURT: All right. Anything else we can clear up this afternoon besides -- I'm getting ready --

MS. WEIS: Your Honor, we had one other question for you about deposition transcripts and objections --

THE COURT: Yeah.

MS. WEIS: -- for the witnesses that we'll be presenting by video testimony, because we need to cut those, you know, sort of cut out the clips and know what testimony is going to be admissible and not well in advance, is it possible to submit the transcripts to you and get a ruling maybe a day before we plan to put on that testimony?

THE COURT: If you give me the transcripts, what I'll do is I'll highlight what the objections are, what you -- what I usually do -- and it's worked pretty well before -- is I'll go through and I'll look at it and then I'll just, you know, in writing, I'll just say, sustained or overruled, and all that kind of stuff, and give them back to

you and you edit it.

And does anybody have a problem with you doing it that way?

MR. COOPER: No, Your Honor.

MR. CLUKEY: No.

THE COURT: So if you don't mind, if you can give those to me tomorrow sometime. I mean, you know, it's too hot to be outside. I'll just read them over the weekend.

MR. DEBEVC: Your Honor, just so I understand, so you need copies of the deposition transcripts that we want to use and highlight the passages?

MS. WEIS: Actually, Your Honor, we've already prepared those and have provided copies of those to the other side and we'll provide copies to the Court tomorrow.

THE COURT: And the same thing goes for y'all. Y'all will probably be going until next weekend, so you can give me what yours are and highlight the objections, and then I'll -- and then I'll just write on them and sustain or overrule it. We can do that in regular -- in the regular depositions, too. And I can read them a lot faster than y'all can read them out loud, okay?

MR. CLUKEY: Thank you.

THE COURT: So just give me a copy of everything with objections, and I can go through and make the rulings.

MR. CLUKEY: Great.

One last thing, Your Honor. We also submitted and put in our proposed jury instructions a set of facts that we believe the Court already ruled on in connection with summary judgment. And perhaps this may be covered tomorrow, just those facts, whether they were, in fact, already established through summary judgment.

MS. WEIS: They are also in our proposed preliminary instruction.

THE COURT: Okay. So we'll take a look at that.

Okay. All right. Anything else, Mr. Cooper?

Mr. Debevc?

MR. DEBEVC: Not at this time, sir.

THE COURT: Okay. Thank you.

All right. What we heard this afternoon, the Motion to Bifurcate I'm going to deny. From what the Government has told me we have 16 witnesses that are common; one witness that is not common.

I'll -- when the not common witness, the one that's just going to testify in your case against Mr. Debevc, regarding Mr. Debevc, as opposed to against Mr. Debevc, you know, I'll charge the jury that this testimony right now is to be considered against in Mr. Debevc's case and only Mr. Debevc's case, it is not to be considered in any way against Mr. Nagy, okay? Or if you want to submit some sort of limiting instruction, I'll be glad to take a look at it.

All right. I'm going to deny the Motion to Strike Mr. Cohen. He's going to be a summary witness, as opposed to an expert. He's not going to be placed as an expert witness. I'll allow him to testify as a summary witness.

I'm going to grant the Motion in Limine about John Kern. I mean, there is no identification with the July cutoff, he wasn't announced to the jury as a possible witness, um, the cutoffs were extended by the parties over and over again, which I always approve. The cutoff was last July. He was identified on May the 20th. It's too late.

Now, I'm going to allow the issue of Mr. Nagy's failure to file into evidence under 404(b) as to intent. I mean, the Government has got to prove scienter of a lack of mistake. It's, under 403, the probative value is not greatly outweighed by unfair prejudice, and that's the standard.

Now, how are you -- I mean, did you ask him that in his deposition? Are you going to read his deposition? I mean, I don't see why you need to bring up Mr. Gee to testify that he didn't file it. He probably admitted it.

MR. CLUKEY: If he admits it, then we -- Mr. Gee is in rebuttal, if necessary. If he admits it, we are done.

THE COURT: So I will deny without prejudice the Motion to Strike Mr. Gee as a reply witness, okay?

When it comes -- when we get through the trial, if in fact you want to reiterate that motion, I'll consider it

at the time when I've got a better idea as to, you know, as to what he's going to reply to, and you will have time, and then we'll know not in theory but in fact what the issues are, okay?

All right. Is there anything else that I haven't ruled on that you need a ruling?

All right. Do y'all want to come back here at 10:30 or 11:00 tomorrow morning?

MR. CLUKEY: Yes, Your Honor.

THE COURT: I mean, I'm available. So y'all get together, and you have some things that will help you with your opening statement, as opposed to, you know, some documents that you think you ought to get in, I can try to rule on them tomorrow, so you can use them over the weekend to prepare your opening, okay? All right.

MR. COOPER: Thank you.

THE COURT: Opening. Who is -- have y'all decided who is going to go first and who is going to be second?

MR. COOPER: Well, I mean, obviously I would like to go first.

THE COURT: I think you are -- the first is the lowest number anyway. Do you have any problem with him going first, Mr. Debevc?

MR. DEBEVC: No, Your Honor.

THE COURT: If y'all agree on it, that's fine with

me, all right?

All right. I don't have any limitations. I do have limitations, direct, cross, redirect, recross, over, okay? So there is no reredirect and rerecross. So you know, it cuts both ways.

Please spend some time and try to mark everything into evidence that you can agree on being into evidence, and go ahead and mark it into evidence, and then you don't have to identify -- if it's in evidence, you can use it without even mentioning it. If y'all agree it's in evidence, you can use it in your opening, you don't have to identify them when it comes to the witness and it makes things go a lot faster.

All right. Yeah?

MR. CLUKEY: Sorry. Also in our pretrial brief, since John Douglas is no longer in the case, we were wondering if it would be possible to give just one person, one government counsel ECF filing privileges.

THE COURT: Gail, how about that?

THE CLERK: I can get in touch with Columbia and see if they can do that.

THE COURT: Why don't you get in touch with Columbia and tell them to do that?

THE CLERK: Tell them. I will.

THE COURT: All right. Anything else?

Okay. All right. I'll see y'all at quarter to 11

tomorrow morning. And if you -- if you decide that you don't need to see me, let me know and I'll take the afternoon off. If not, I'll be here.

***** ***** *****

I certify that the foregoing is a correct transcript from the record of proceedings in the above-titled matter.

Amy C. Diaz, RPR, CRR February 21, 2011

S/ Amy Diaz